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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. [redacted]108

MILL RIDGE COAL COMPANY,
Petitioner,

VERSUS

GEORGE D. PATTERSON, District Director of Internal Revenue,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit

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OPINIONS BELOW

The opinion of the Court of Appeals is officially reported at 264 F. 2d 713 and is unofficially reported at 3 A.F.T.R. 2d 921 (1959); that opinion is printed in the Appendix to this petition. The charge of the District Court to the jury (R. 89-103), containing its reasons for directing a verdict in favor of the respondent on the questions here presented, is unofficially reported at 1 A.F.T.R. 2d 167 (1958) and at 58-1 U.S.T.C., p. 68,316 (1958).

JURISDICTION

The date of the judgment sought to be reviewed, and the time of its entry, is March 12, 1959.

The statutory provision believed to confer on this court jurisdiction to review the judgment in question by writ of certiorari is Title 28, Section 1254(1), United States Code (62 Stat. 928).

QUESTIONS PRESENTED

(1) Whether petitioner, a single corporate taxpayer that has never been a party to a merger or other form of corporate reorganization, which withdrew from an unprofitable business and entered a new business out of which it sought to recoup its earlier losses, will be denied a deduction of a portion of its earlier losses from income earned in a fiscal year because of the decision of this Court in *Libson Shops, Inc.* v. *Koehler,* 353 U.S. 382 (1957), which held that a corporation surviving a merger may not carryover and deduct premerger net operating losses of one type of business against the post-merger income from another type of business, both of which businesses were operated and taxed separately prior to the merger?

(2) Alternatively, whether *Libson Shops, Inc.* v. *Koehler, supra,* which was decided under Section 122 of the Internal Revenue Code of 1939, governs the construction of Section 172 of the Internal Revenue Code of 1954, which this case involves?

(3) Whether petitioner, whose stock was acquired by new owners, may be denied, under Section 269 (a)(1) of the 1954 Code the right to deduct its own net operating loss carryover, when neither the petitioner nor the new owners of petitioner's stock acquired any deductions which it or they would not have

had irrespective of the purchase of petitioner's stock by the new owners?

STATUTES INVOLVED

The statutes involved in this case are contained in the Appendix. They are Sections 172 (68 A. Stat. 63) and 269(a) (68 A. Stat. 80) of the Internal Revenue Code of 1954 [Title 26, U. S. C., Sections 172 and 269(a)] and Section 122 (53 Stat. 867, amended, 67 Stat. 807, 844, 847, 848; amended, 64 Stat. 918, 937; amended, 64 Stat. 1220; amended, 65 Stat. 500, 505, 517; amended, 67 Stat. 619) of the Internal Revenue Code of 1939 [Title 26 (I.R.C. 1939), Section 122].

STATEMENT OF THE CASE

The facts we believe relevant to the questions presented above are these: Petitioner, a corporation, was organized in 1947. It reports its income for federal tax purposes on a fiscal year ending August 31. From its organization until September, 1952, petitioner was engaged in mining and selling coal and in leasing its coal mining properties (R. 15-16). The business was unsuccessful, and during its fiscal years ended in 1949 through 1953, petitioner incurred substantial net operating losses (R. 15). Finally, on September 1, 1952, petitioner sold its physical assets for a $71,648.61 note, secured by a mortgage, on which it made collections until December 31, 1953 (R. 16). On that latter date, the note and mortgage were transferred by petitioner to one of its stockholders in satisfaction of certain debts (R. 16, 35). On the same day, the stockholders sold the stock of the petitioner (R. 17). Under its new ownership, petitioner began transporting and selling bunker fuel oil. The business was relatively successful and petitioner began to recoup the losses that it had

incurred in earlier years while it was in the coal business (R. 104, 63, 64-5).

On its federal income tax return for the fiscal year ended August 31, 1955, petitioner carried forward and deducted from its income an appropriate amount of the net operating losses incurred by it during its fiscal years ended 1951 through 1954. The respondent disallowed the deduction, and asserted that petitioner owed a deficiency, relying on Section 129(a) of the Internal Revenue Code of 1939 (R. 10). Petitioner paid the deficiency and filed claim for refund. The respondent denied the claim and petitioner brought suit for refund in the District Court, jurisdiction being conferred thereon by Title 28, Section 1390, U. S. Code.

The District Court found that the principal purpose of the new stockholders in purchasing the stock of the petitioner was the avoidance of taxes. The District Court further found that at the time of the purchase, the law appeared to be well settled that the petitioner could not be deprived of its use of the carryforward under the circumstances of this case, and that the new stockholders were exercising honest business judgment in purchasing the stock (R. 92). The District Court held that the respondent had erroneously disallowed the net operating loss deduction under Section 129(a) of the 1939 Code because petitioner, immediately prior to the purchase of the stock, had the net operating loss carryforward and thus the purchase of its stock did not result in securing to petitioner any deduction the right to which it did not already have. The District Court further held that the new stockholders of petitioner did not acquire any deductions by reason of their purchase of the stock because they, being taxpayers separate from the petitioner, are not

entitled to use petitioner's net operating loss carry-forward (R. 92), and therefore Section 129(a) of the 1939 Code did not apply.

The District Court, however, directed a verdict for the respondent on the ground that petitioner was not entitled to the deduction by reason of the decision of this Court in *Libson Shops* v. *Koehler, supra*. On appeal (R. 116-123), the Court of Appeals affirmed the judgment but reversed the District Court in part, holding that petitioner was denied the deduction not only by reason of the decision of this Court in *Libson Shops* v. *Koehler, supra*, but also by reason of Section 129(a) of the 1939 Code.

REASONS FOR GRANTING THE WRIT

(1) The Court of Appeals has decided an important federal question in conflict with Libson Shops, Inc. v. Koehler, supra, in that the Court of Appeals has ruled that the rationale of Libson Shops applies to a single corporate taxpayer that changes its business, whereas this Court specifically stated that it was not passing upon such situations.

The Court below held that the taxpayer, a single continuing corporation which has never been a party to a merger or any other form of reorganization, became a new "taxpayer", for purposes of Section 122 of the 1939 Code, when it got out of the coal business and entered the bunker fuel oil business. The Court below so ruled in spite of the fact that this Court stated that *Libson Shops* does not deal with single continuing corporations, *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, 390 (1957), footnote 9, and in spite of the fact that all of the decisions on this issue hold that a change of business by a continuing corporation does not result in a "new" taxpayer. *Northway Securities Company*, 23 B.T.A. 532 (1921), Acq. X-2 C.B. 52 (1931); *Alprosa Watch Corp.*, 11 T.C. 240 (1948);

A. B. & Container Corp., 14 T.C. 842 (1950); *W A G E, Inc.*, 19 T.C. 249 (1952); *Great American Industries, Inc.*, 25 T.C. 1160 (1956).

(2) The Court of Appeals has rendered a decision on two important questions of federal law that squarely conflicts with the decisions of the Tax Court of the United States.

On facts indistinguishable from those here, and faced with contentions by the government identical with those made to the Court below, the Tax Court of the United States in *British Motor Car Distributors, Inc.*, 31 T.C. No. 44(1958) (reviewed by the entire Court, five judges dissenting), held for the taxpayer, ruling that *Libson Shops* v. *Koehler, supra,* does not apply to single continuing corporations, and that Section 129(a) of the 1939 Code [now Section 269(a) of the 1954 Code] is not applicable to instances of this nature in which neither the corporation nor the new stockholders obtain any deduction that it or they would not have had irrespective of the stock purchases. The Tax Court specifically held that the benefit interdicted by Section 129(a) of the 1939 Code was the direct use of the deduction by the acquiring person and any indirect benefit to a stockholder of a corporation with a loss carryover was not within Section 129(a)(1). The decision of the Tax Court with respect to its second ruling is consistent with all of its earlier decisions on the construction of Section 129(a) of the 1939 Code. *Alprosa Watch Corp., supra; Commodores Point Terminal Corp.*, 11 T.C. 240 (1948), Acq. 1949-1 C.B. 1; *W A G E, Inc., supra; T. V. D. Co.*, 27 T.C. 879 (1957).

On March 11, 1959, the Government indicated that it would petition to the Court of Appeals for the Ninth Circuit for a review of the decision of the Tax Court in *British Motor Car Distributors, Inc., supra.* (See

1959 P-H Para. 56,366.) In the event that decision is affirmed, a conflict will result between the Courts of Appeal for the Fifth and the Ninth Circuits. Even if reversed, however, there will still exist a conflict between those two Courts of Appeal and the Tax Court [see *Arthur L. Lawrence*, 27 T.C. 713 (1957)], until that conflict is resolved by this Court.

(3) The Court of Appeals applied the provisions of the 1939 Code to this case, which involves a taxable year ended August 31, 1955, as to which the provisions of the 1954 Code, not those of the 1939 Code, are applicable. The failure of the Court below to apply the correct law to this case is such a departure from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

This case involves a claim for refund based on a deficiency paid with respect to the taxable year that began September 1, 1954 and ended August 31, 1955. During that taxable year, the relevant sections of the 1954 Code (unless otherwise expressly stated), not those of the 1939 Code, were in force. Section 7851 (a)(1)(A), 1954 Code.

The Court below seems to have held, however, that the provision of the 1939 Code governed this case: "the taxpayer here, as in the *Libson* case, *supra*, is not 'the taxpayer' within the meaning of 26 U.S.C.A., Sec. 122(b)(2)(C),". (App. 11a). The fact is, however, that Section 172 of the 1954 Code, not Section 122 of the 1939 Code, is applicable to this case, and the words "the taxpayer" that appear in Section 122 of the 1939 Code do not appear in the relevant portions of Section 172 of the 1954 Code.

(4) The Court of Appeals has decided erroneously that Libson Shops, Inc. v. Koehler, supra, is applicable under the 1954 Code. This federal question, of utmost importance to tax practitioners should be decided by this Court.

The Court of Appeals applied its interpretation of *Libson Shops, Inc.* v. *Koehler, supra,* to a year governed by the 1954 Code. The Treasury Department has expressly stated that *Libson Shops* is not applicable to the 1954 Code. See *Technical Information Release,* No. 89, issued August 25, 1958. See also Sinrich, "Libson Shops—An Argument Against Its Application Under the 1954 Code", 13 *Tax L. Rev.* 167 (Jan., 1958). It appears that if *Libson Shops* applies to a single corporate taxpayer and is applicable under the 1954 Code, the provisions of Section 382(a) have been substantially narrowed by judicial fiat. That Section—new to the law and not applicable to this case (because of its effective date)—provides that a single corporation loses the benefit of its loss carryforward only if *both* its business is changed *and* there is a substantial change in the ownership of its stock. Yet under the decision below, a single corporation would lose its carryforward upon a change of business only. It appears also that, under Sections 381 and 382(b) of the 1954 Code, a corporation surviving a merger may use its own carryforward and those of the constituent corporations, regardless of a change of business, provided only certain stock ownership tests are met. Thus, the decision of the Court below renders it impossible for taxpayers and their advisers to rely, with safety, on what appears to be the plain language of the 1954 Code.

ARGUMENT

Section 172 of the 1954 Code

This case involves, in the first instance, the proper construction of the net operating loss provisions of the 1954 Code. The principal question raised in this respect—whether a corporation may carry forward and deduct net operating losses incurred by it in prior years in one type of business from subsequent income produced by it in another type of business—is of importance to all of the many corporate taxpayers that have changed or plan to change business activities. The question would appear to be of crucial importance to the many relatively small corporations, whose operations are not frozen to heavy plant investment and whose lines of business may therefore be subject to change as new business opportunities are presented. As indicated by a recent government survey, the active small corporations (with assets of less than $25,000) filing Federal income tax returns showed a total overall deficit of $124,860,000 during the twelve months ended June 30, 1956, of which all or a substantial portion is available as a net operating loss carryforward. In addition, during that year, these corporations claimed total net operating loss carryforward deductions of $41,919,000. Furthermore, the active corporations with assets between $25,000 and $50,000 claimed

total net operating loss deductions during that period of almost 50% of their total net profits.[1]

It is primarily these corporations—for whose benefit so much legislation has been recently enacted—that will bear the brunt of the ruling of the Court below. We submit therefore that the decision of the Court below deals with matters of public importance that should be considered by this Court.

The decision of the Court below is based on its holding that *Libson Shops, Inc.* v. *Koehler, supra,* applies to single corporations. That holding is not only unwarranted by the very language of the opinion in *Libson Shops*, but is also in irreconcilable conflict with the decision of the Tax Court of the United States. See

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[1] During the year ended June 30, 1956 (the most recent period for which statistical data is available), all active corporations filing federal income tax returns claimed as deductions a total of $836,133,000 in net operating loss carryforwards. The data below, for the year ended June 30, 1956, shows the relative importance of the loss carryover deduction to small corporations:

	Number	Total Assets	Net Profit	Net Operating Loss Deduction Claimed
		(1,000's)	(1,000's)	(1,000's
All active corporations *	746,962	$87,374,680	$47,601,137	$814,86
Corporation, by size of assets				
0-$25,000	185,260	347,873	(124,860) †	41,91
$25,000-$ 50,000	114,304	530,476	88,034	41,03
$50,000-$100,000	131,510	1,088,667	352,669	74,56

* As to which balance sheets were filed with the tax returns.

† Net loss or deficit.

Data compiled from: U. S. Treasury Department, Internal Revenue Service, Publication No. 16(6-58), "Statistics of Income—1955, Corporation Income Tax Returns for Tax Years Ended July 1955-June 1956."

British Motor Car Distributors, Inc., supra, where the Tax Court said:

> "With reference to the applicability of *Libson Shops, Inc.* v. *Koehler,* supra, we do not understand the opinion of the Supreme Court in that case to cut as deeply as the Commissioner contends. There, 16 sales corporations were merged into petitioner and the effect 'was to convert 16 retail businesses and one managing agency, reporting their incomes separately, into a single enterprise filing one income tax return'. The Supreme Court held that the petitioner could not make use by way of carry-over of the previously sustained net operating losses of some of the merged corporations. This conclusion was apparently based upon a holding that petitioner was not the same taxable entity as that which sustained the loss and reliance was placed on the interpretation of the term 'the taxpayer" as it is used in section 122(b)(2), Internal Revenue Code of 1939. The Commissioner makes use of some of the language of the Supreme Court in *Libson Shops* in his argument here, but we think the language is not controlling, first because the fact situations in *Libson* and the case before us are dissimilar and second, and more strongly, because the Court in footnote 9 to *Libson* said:
>
> > "We do not pass on situations like those presented in Northway Securities Co. v. Commissioner, 23 B.T.A. 532; Alprosa Watch Corp. v. Commissioner 11 T.C. 240; A. B. & Container Corp. v. Commissioner, 14 T.C. 842; WAGE, Inc., v. Commissioner, 19 T.C. 249. In these cases, a *single* corporate taxpayer changed the character of its business and the taxable income of one of its enterprises was reduced by the deductions or credits of another.'
>
> "The case before us involves the same kind of situation as that described in the footnote referred

to above. Here we have a single corporate taxpayer which changed the character of its business and claims the right to reduce the taxable income of one of its enterprises, the automobile business, by the losses of another, the appliance business. The cases cited in the footnote have held that this could be done, and so far as we can see, the Supreme Court has not held otherwise in *Libson*."

The decision of the Tax Court was reviewed by the entire Court (5 judges dissenting). It may be anticipated, therefore, that the Tax Court will adhere to that position regardless of the position taken by the Court below and regardless of the position taken by the Court of Appeals for the Ninth Circuit, until the question is determined by this Court.

We submit that this Court should grant certiorari in order that the conflict on this important question be finally determined.

The preceding paragraphs have been predicated on the assumption that, in basing its decision in part on *Libson Shops* v. *Koehler*, the Court below construed that decision as governing Section 172 of the 1954 Code. This assumption seems warranted, in view of the fact that the taxable year involved in this case commenced September 1, 1954, and ended August 31, 1955, a period governed by the provisions of the 1954 Code. See Section 7851(a)(1)(A) of the 1954 Code. The various references in the opinion of the Court below to provisions of the 1939 Code, however, and the apparent refusal of the Court to agree with the petitioner that the 1954 Code is applicable, may suggest that the decision below is predicated upon a belief that the provisions of the 1939 Code, and not those of the 1954 Code, govern this case. If such was the view

of the Court below, its basis was probably the fact that the net operating losses sought to be deducted in a year governed by the 1954 Code were incurred in years during which the 1939 Code was applicable. However, Section 172 of the 1954 Code specifically states that reference shall be made to the 1939 Code only to determine the computation of the net operating loss and the number of years that it may be carried forward, questions not in dispute in this case. If the Court below based its decision on the 1939 Code, we submit that the decision below is such a departure from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

In the light of the clear error of applying the provisions of the 1939 Code to this case, we believe it is more reasonable to assume that the Court below held that the 1954 Code governed this case, but that Section 172 of the 1954 Code must be construed in the light of *Libson Shops* v. *Koehler*. Thus, we construe the holding of the Court below to be that *Libson Shops* v. *Koehler* is applicable under the 1954 Code. We believe that such a holding conflicts with other provisions of the 1954 Code and should not be permitted to stand. For example, the precise holding in *Libson Shops* v. *Koehler*, decided under provisions of the 1939 Code, is in conflict with Sections 381 and 382(b) of the 1954 Code, in that these sections appear to provide generally that, if certain stock ownership tests are met, a corporation surviving a merger will be able to use the entire loss carryforward of the other corporations parties to the merger, even though the effect thereof will be to permit losses from one type of business to be offset against profits from another type of business. See Sen. Rep. No. 1622, p. 52, 83d Cong., 2d Sess.

If it be assumed that *Libson Shops* applies to the single continuing corporation, a ruling under the 1954 Code that a single continuing corporation loses its net operating loss carryforward upon a change of business conflicts with the provisions of Section 382(a) of the 1954 Code. That subsection provides that a single continuing corporation may lose its loss carryforwards if there is both a change of business and a substantial change in stock ownership, the inference being that a change of business of itself will not affect the corporation's net operating loss carryforwards.

The ruling of the Court of Appeals that *Libson Shops* is applicable in construing the provisions of the 1954 Code seems to be based upon a misconception as to the real significance of that decision. *Libson Shops*, which was expressly based on provisions of the 1939 Code, hinges on the meaning of the term "taxpayer" that appeared in Section 122 of the 1939 Code. That term does not appear in the relevant portions of Section 172 of the 1954 Code. Furthermore, this Court decided *Libson Shops*, as we understand that decision, in order to clarify certain conflicts that had arisen under the 1939 Code with respect to the effect of mergers and other reorganizations on the loss carryovers of constituent and surviving corporations. See Sen. Rep. No. 1622, p. 52, *supra*. In the light of Sections 381 and 382 of the 1954 Code, however, those conflicts do not exist under present law. It seems clear that a rule to the effect that *Libson Shops* governs Section 172 of the 1954 Code—the apparent rule of the Court below—will result in defeating the clear provisions of the 1954 Code relating to the effect on carryforwards of mergers and other reorganizations. Sections 381 and 382.

We submit that the question whether *Libson Shops* is to be followed under the 1954 Code is an important question that should be considered by this Court.

Section 269 of the 1954 Code

This case involves, in the second instance, the proper construction of Section 269(a) of the 1954 Code. The District Court in holding that Section 129(a) of the 1939 Code [now Section 269(a) of the 1954 Code] was not applicable to this case said:

> "In the first place, the acquisition by the present stockholders of the control of the plaintiff corporation did not serve to secure to the present stockholders any deduction credit or other allowance which such person, meaning the new stockholders or any one of them, or the corporation, would not otherwise enjoy. The plaintiff, which is the Mill Ridge Coal Company, before the sale of its stock was entitled to the benefit of a net operating loss carryover. Therefore the acquisition of the control of the plaintiff by the present stockholder did not result in securing to the plaintiff, the corporation, the net operating loss carryover because it already had it. The present stockholders did not secure any deduction credit or other allowance through their acquisition of the stock from the DeBardelebens because they, as individuals and for the purpose of applying this section there is a distinct difference between the corporate entity and the stockholders, they themselves are not entitled, they are not claiming as individual stockholders the benefit of a net operating loss carryover."

The Court of Appeals reversed the District Court in this respect, although its reasons for doing so are not clear. The ruling of the Court below conflicts squarely with the considered opinions of the Tax Court

in many decisions, the most recent of which is *British Motor Car Distributors, Inc., supra.* In that decision the Tax Court stated:

> "While it is true that section 129 did not control the situation in *Alprosa Watch Corporation,* 11 T.C. 240 the Commissioner nevertheless made the 'suggestion' that the legal principles set forth in that section 'may well have been the law existing prior' to its enactment. In disposing of this argument the Court said:
>
> > 'There is considerable doubt in our minds that, even assuming that this case were to be governed by section 129, the facts constitute a situation condemned by that section. That section would seem to prohibit the use of a deduction, credit, or allowance only by the *acquiring person or corporation* and not their use by the corporation whose control was acquired. [Emphasis supplied.]
>
> "While the Court's language in *Alprosa Watch* has been characterized as dictum by some (see Tarleau, Acquisition of Loss Companies, Taxes, Vol. 31, 1050, 1054), we have given effect to it, inferentially, at least, in *A. B. & Container Corporation,* 14 T.C. 842; *WAGE, Inc.,* 19 T.C. 249; and *T. V. D. Co.,* 27 T.C. 879, 886. In the latter case, we said, 'It is manifest from the unambiguous terms of section 129 that it applies only to an acquiring corporation.' In the situation before us we have British Motor Car Distributors, Ltd. as petitioner. In effect, petitioner is the acquired corporation, its stock having been acquired by the partnership. It is petitioner, though its majority stock was acquired by the partnership, which is here seeking to make use of its previous losses. While its new stockholders may gain some tax advantage as stockholders because of petitioner's use of its losses, it is still the petitioner and not the stockholders who seek to claim the benefit in

the case before us. *We think the possible benefit which may flow to the new stockholders is too tenuous a benefit to bring section 129 into play.* The fact that petitioner originally bore a different name which was changed as part of the transaction in which the stock changed hands does not alter the situation. *Alprosa Watch Corporation*, supra, *A. B. & Container Corporation, supra.* Nor does the fact that there has been a change in the business of the petitioner after the acquisition call for a change in the result. Such a change occurred in both the *Alprosa* and *A. B. & Container* cases." (Italics added.)

We submit that Section 269 of the 1954 Code may be applied to this case only if the corporate entity of the petitioner, an active corporation doing business with persons other than its stockholders, can be disregarded, for only in this manner can the present stockholders of the petitioner be said to have secured a "benefit" that springs from petitioner's net operating loss deduction—a deduction that can be claimed only by the petitioner and not by its stockholders. The crux of the Government's argument, both in brief and at oral argument in the Court below, was that the taxpayer's new stockholders obtained a benefit which they would not otherwise enjoy. The benefit interdicted by Section 269 of the 1954 Code is the direct use of a deduction by the acquiring person, and this did not occur in this case. If it be assumed that the corporate entity may be pierced for purposes of Section 269, we submit that a piercing of the corporate veil in this case—involving an active going corporation doing business with persons other than its stockholders—would conflict with long standing decisions of this Court. *National Carbide Corp.* v. *Commissioner*, 336 U. S. 342 (1949); *Dalton* v. *Bowers*, 278 U. S. 404

(1932); *Burnett* v. *Commonwealth Improvement Co.*, 307 U. S. 14 (1932). Moreover, here the Government has collected the taxes in question from the taxpayer corporation and thus has recognized the corporation as the taxable entity in this case. *Mead Corp.* v. *Commissioner*, 116 F. 2d 187 (3rd Cir., 1940); *A. B. & Container Corp., supra.*

The Government has claimed erroneously that the business purpose requirement of *Gregory* v. *Helvering*, 293 U. S. 465 (1935) was not met in this case. The rule of the *Gregory* case was clearly met in this case because the taxpayer corporation is not a sham corporation, as was the case in *Gregory*. The taxpayer corporation in this case is a separate corporate taxpayer actively conducting a business enterprise entirely apart from its stockholders, and is conducting that business for valid business purposes. Accordingly, the *Gregory* case is not applicable. For the same reason the doctrine of *Higgins* v. *Smith*, 308 U. S. 473 (1939) is not applicable to this case.

CONCLUSION

The decision of the Court of Appeals deals erroneously and ambiguously with matters of importance. We respectfully request that the writ of certiorari be issued.

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APPENDIX

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 17392

MILL RIDGE COAL COMPANY,

Appellant,

VERSUS

GEORGE D. PATTERSON, District Director of Internal Revenue,

Appellee.

Appeal from the United States District Court for the Northern District of Alabama

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(March 12, 1959)

Before HUTCHESON, Chief Judge, and CAMERON and BROWN, Circuit Judges.

HUTCHESON, Chief Judge: This appeal, re-presenting here the claim for refund ineffectually urged below, that in paying the deficiency assessed against it for its fiscal year ending August 31, 1955, taxpayer overpaid its taxes, seeks a reversal of the adverse judgment. This claim was, and is, based upon taxpayer's contention that the commissioner erroneously denied it the right to deduct from its income for that year a net operating loss carry-over deduction which was based on a loss sustained by it prior to that year.

On the facts,[1] established by stipulation and undisputed testimony, the district judge, disagreeing with the reason assigned by the commissioner for the disallowance of the deduction, that it was required by Sec. 129(a) I.R.C.

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[1] Taxpayer is a Kentucky corporation organized on Sept. 18, 1947, with an authorized capital stock of 200 shares, all of which was owned by Charles and Prince DeBardeleben. The corporation operated a coal mine in Harlan County, Kentucky, and sold coal from Sept., 1948, until March, 1951.

In March, 1951, taxpayer ceased operating the mine and leased it to the Southern Kentucky Coal Company until February, 1952. From July, 1952, until September, 1952, taxpayer leased the mine to Harcrow Coals, Inc. From September, 1952, until Dec. 31, 1953, taxpayer conducted no business or operations. Taxpayer incurred a net loss during every fiscal year between August 31, 1948, and August 31, 1953.

On September 1, 1952, taxpayer sold all its physical assets, receiving in payment a secured note which it held until Dec. 31, 1953, when it was transferred to Charles and Margaret DeBardeleben. As of December 31, 1953, taxpayer's balance sheet showed zero assets and $297,140.35 worth of liabilities.

In 1949, William E. Tomlinson and R. W. Reynolds began negotiating with the Tennessee Coal and Iron Division of the United States Steel Corporation to purchase fuel oil in Baton Rouge, Louisiana, and transport it by barge and truck to TCI at Birmingham.

On Dec. 3, 1953, TCI agreed to enter such a contract. Tomlinson and Reynolds formed the Bunker Oil Company in November, 1953, through which they intended to carry out the operation. In an effort to raise capital, Tomlinson sought to sell stock to Elliott T. Williams. Williams recollected that Tomlinson approached him in October or November, 1953.

On Dec. 31, 1953, Charles and Prince DeBardeleben sold all their stock in taxpayer and taxpayer's notes, all of which they held, to Williams for $5,475.52. At that time Williams was aware of the pending contract between the Bunker Oil Company and TCI. He testified that the principal reason for buying the corporation was to get the tax benefit of its earlier losses. On Feb. 26, 1954, stock certificates in taxpayer were issued to Tomlinson, Williams, Williams' brother, James B. Morgan, and John N. Harbert III. Tomlinson testified that one of the major reasons he purchased stock in taxpayer was to obtain the tax benefit of its earlier losses.

Thereafter on March 17, 1954, TCI and taxpayer executed a formal contract providing for the transportation and sale of oil

(1939),[2] nevertheless sustained the determination of the deficiency on the ground that the reasoning of the Supreme

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by taxpayer to TCI. Taxpayer began to sell fuel oil to TCI on August 31, 1954.

Bunker Oil Company never did any business and was dissolved in 1954.

Taxpayer never engaged in any coal purchasing or selling activities after the DeBardelebens sold their stock in it.

On its income tax return for the fiscal year ended August 31, 1955, taxpayer sought to carry over and deduct the losses it had incurred in the coal business while its shares had been owned by the DeBardelebens. The District Director of Internal Revenue proposed a deficiency which taxpayer paid. Taxpayer's claim for a refund was denied, and taxpayer filed this suit. The District Court directed a verdict for the Director on the issue involved here.

[2] "Sec. 129. Acquisitions Made to Evade or Avoid Income of Excess Profits Tax.

"(a) Disallowance of Deduction, Credit, or Allowance. —If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation.

"(b) Power of Commissioner to Allow Deduction, Etc., in Part.—In any case to which subsection (a) is applicable the Commissioner is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion of avoidance

Court, in *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, and the result in that case, required it.[3]

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of Federal income and excess profits tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2)."

[3] Saying in that case:

"We are concerned here with a claim to carry over an operating loss to the immediately succeeding taxable year. The particular provision on which petitioner's case rests is as follows:

'If for any taxable year beginning after Dec. 31, 1947, and before Jan. 1, 1950, *the taxpayer* has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years. . . .' (emphasis supplied) Sec. 122(b)(2)(C) 64 Stat. 937, 938, 65 Stat. 505, 26 U.S.C. Sec. 122(b)(2)(C).

"The controversy centers on the meaning of 'the taxpayer'. The contentions of the parties require us to decide whether it can be said that petitioner a combination of 16 sales businesses, is 'the taxpayer' having the pre-merger losses of three of those businesses." (p. 385)

the court, after concluding that petitioner was not "the taxpayer", went on to say:

"We do not imply that a question of tax evasion or avoidance is involved. Section 129(a) of the 1939 Code, as amended, does contain provisions which may vitiate a tax deduction that was made possible by the acquisition of corporate property for the 'principal purpose' of tax evasion or avoidance. And that section is in applicable here since there was no finding that tax evasion or avoidance was the 'principal purpose' of the merger. The fact that Sec. 129(a) is inapplicable

Taxpayer, appealing from the judgment against it, is here presenting a single question for decision. This is:

> The taxpayer corporation incurred losses while engaged in the coal mining business. The corporation disposed of all its assets and the corporate shares were then sold to new owners who engaged in the oil transportation business in the corporate name. The question is whether taxpayer is entitled to carry over the losses previously incurred, in view of the admitted principle purpose of its new shareholders in acquiring the shares to avoid taxes.

Arguing that the district judge was right in holding that Section 129(a) of the 1939 Code and its successor, Sec. 269(2) of the 1954 Code were not applicable to this case, the taxpayer citing Tax Court decisions, Northways Sec. Co., 23 B.T.A. 532; A.B. & Container Corp., 14 T.C. 842; W A G E, Inc., 19 T.C. 249; and urging upon us: that it has long been established that a single corporate taxpayer may deduct from income earned by it in one type of business in one taxable year a net operating loss sustained by it in another type of business in a prior taxable year; and that a change of business by a single corporate taxpayer does not destroy that corporation's right to carry forward its own net operating losses; insists that this rule was not changed by the decision or the opinion in the Libson case.

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does not mean that petitioner is automatically entitled to a carry-over. The availability of this privilege depends on the proper interpretation to be given to the carry-over provisions. We find nothing in those provisions which suggests that they should be construed to give a 'windfall' to a taxpayer who happens to have merged with other corporations. The purpose of these provisions is not to give a merged taxpayer a tax advantage over others who have not merged. We conclude that petitioner is not entitled to a carry-over since the income against which the offset is claimed was not produced by substantially the same businesses which incurred the losses." Libson Shops v. Koehler, 382 U.S. 382, at p. 388-9 and 390.

Calling attention to the fact that the Supreme Court, in footnote 9, 353 U.S. 390, said that it was not passing upon the instances in which a single corporate taxpayer changes its business, and assuming arguendo that that decision might apply to a single corporate taxpayer under Sec. 122(b)(2)(b) of the 1939 Code, it insists that that decision is not applicable to this case because the deduction here involved was taken by appellant in its taxable year ending 1955. Distinguishing to its own satisfaction the decision in *Coastal Oil Storage Co.* v. *Commissioner*, 242 F. (2) 396, relied on by the commissioner, on the ground that that case involved the creation of a new surtax exemption created by splitting up a profitable business and the deduction was disallowed by ignoring the separate taxable entity of the new subsidiary, appellant insists that its separate corporate taxable entity cannot be ignored here because appellant is a corporation operating an active business entirely separate and apart from its stockholders and as such has an entity and existence entirely separate and apart from them.

The United States, on its part, points as concluding the issue against appellant to the fact that the only, indeed the admitted, purpose of the purchase from the DeBardelebens of the stock of appellant, a corporation, having no assets and heavy losses, was to produce the very mischief aimed at in Sec. 129(a) I.R.C. 1939, and its successor, Sec. 269(a) of the 1954 Code, securing the tax benefits of a deduction of previous losses incurred in a different business and with different stockholders and management, against the expected great profits to be derived from the new business then being solicited by Bunker corporation for it as the heir apparent.

Pointing, too, to the fact that all of this having been arranged and confected by careful preconcert, Bunker Corporation was dissolved and the taxpayer, refurbished and reborn as Bunker's alter ego and successor, with Bunker's

stockholders and Bunker's business prospects, took over and engaged in the business, of transporting and selling oil, a business Bunker was formed to do, it insists that to permit the deduction from the expected and realized profits of the large loss carryover deduction, which was the only thing that made its acquisition by Bunker and its stockholders desirable, would be not only contrary to the construction given the carryover statute in the Libson Shops decision, *supra*, but also in the teeth of the statutes enacted to prevent this very form of tax avoidance. Emphasizing and reemphasizing that taxpayer's new stockholders had no authentic business purpose in dissolving Bunker and acquiring taxpayer through the purchase of its stock, but only the purpose of accomplishing what Sec. 129(a) of the 1939 Act and Sec. 269(a) of the 1954 Act were enacted to prevent, the abuse of loss carry-over deductions for the purpose of tax avoidance, the United States insists that the allowance of the claimed loss carry-over deduction here as a result of this neatly confected arrangement, having no business purpose and no business result, but only the purpose of avoiding taxes and achieving a tax windfall, would result in an unjust enrichment which the carry-over statute did not intend and the above referred to sections forbid.

We find ourselves in complete agreement with these views. The language and the legislative history of the enactment of the loss carry-over provisions make it quite clear that congress did not intend thereby to authorize unjust enrichments through windfalls of the kind claimed here. On the contrary, the statute, a remedial one, intended to and did provide amelioration for the drastic effects under particular circumstances of taxing income on an annual basis by allowing a business with fluctuating profits to set off its lean, against its good, years, and it cannot be reasonably contended that in enacting the carry-over provisions, congress contemplated or authorized the

trading in, and use of, the loss carry-over deduction involved here. Indeed the facts are so clear, the purpose and results of the actions taken are so obviously in conflict with the meaning and intent of the remedial statute appellant invokes that if, as we do not believe is the case, the transaction at issue here can be said to be within the letter of the statute, it is foreign to its spirit and its clearly expressed overall purpose and intent.

Agreeing with appellee, therefore, that the taxpayer here, as in the Libson case, *supra*, is not "the taxpayer" within the meaning of 26 U.S.C.A., Sec. 122(b)(2)(C); and that under the undisputed facts and the findings in this case, the allowance of the deduction is forbidden by Sec. 129(a) 1939 Code, we order the judgment

AFFIRMED.

A true copy
Test: EDWARD W. WADSWORTH
Clerk, U. S. Court of Appeals, Fifth Circuit
New Orleans, Louisiana
March 27, 1959

Judgment

Extract from the Minutes of March 12, 1959.

No. 17392

MILL RIDGE COAL COMPANY,

VERSUS

GEORGE D. PATTERSON, District Director of Internal Revenue.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District Court for the Northern District of Alabama, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

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STATUTES INVOLVED

Internal Revenue Code of 1939

SEC. 122. NET OPERATING LOSS DEDUCTION.

(a) Definition of Net Operating Loss.—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) Amount of Carry-Back and Carry-Over.—

(1) Net operating loss carry-back.—

(A) Loss for taxable year beginning before 1950.—If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c).

(B) Loss for taxable year beginning after 1949.—If for any taxable year beginning after December 31, 1949, the

taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year.

1939 Code

(2) Net operating loss carry-over.—

(A) Loss for taxable year beginning before 1948.—Except as provided in subparagraphs (D) and (E), if for any taxable year beginning before January 1, 1948, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss, without regard to any net operating loss carry-back, and without regard to any reduction specified in subsection (c).

For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

(iii) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c).

(B) Loss for taxable year beginning after 1949.—If for any taxable year beginning after December 31, 1949, the

taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for each intervening taxable year, without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1949, shall be reduced by the amount, if any, of the net income for the preceding taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for such preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c).

(C) Loss for taxable year beginning after December 31, 1947, and before January 1, 1950.—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall

be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for each intervening taxable year without regard to such net 1939 Code
operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1947, and before January 1, 1950, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

(iii) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c).

* * * * * * *

(c) Amount of Net Operating Loss Deduction.—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26 (h) and (i)).

(d) Exceptions, Additions, and Limitations.—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) The amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from such sales or exchanges. The deduction provided in section 23 (ee) shall not be allowed.

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph, deductions and gross income shall be computed with the exceptions, additions, and limitations specified in paragraphs (1) to (4) of this subsection. This paragraph shall not apply with respect to deductions allowable for losses sustained after December 31, 1950, in respect to property, if the losses arise from fire, storm, shipwreck, or other casualty, or from theft.

* * * * * * *

(c) No Carry-Back to Year Prior to 1941.—As used in this section, the term "preceding taxable year" and the term "preceding taxable years" do not include any taxable year beginning prior to January 1, 1941.

* * * * *

SEC. 129. ACQUISITIONS MADE TO EVADE OR AVOID INCOME OR EXCESS PROFITS TAX.

(a) Disallowance of Deduction, Credit, or Allowance.—If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation.

(b) Power of Commissioner to Allow Deductions, Etc., in Part.—In any case to which subsection (a) is applicable the Commissioner is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

1954 Code

Internal Revenue Code of 1954

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) Deduction Allowed—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) Net Operating Loss Carrybacks and Carryovers.—

(1) Years to which loss may be carried.—A net operating loss for any taxable year ending after December 31, 1957, shall be—

(A) a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss, and

(B) a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(2) Amount of carrybacks and carryovers.—Except as provided in subsection (i), the entire amount of the net operating loss for any taxable year (hereinafter in this

section referred to as the 'loss year'), shall be carried to the earliest of the 8 taxable years to which (by reason of subparagraphs (A) and (B) of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other 7 taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—

(A) with the modifications specified in subsection (d) other than paragraphs (1), (4), and (6) thereof; and

(B) by determining the amount of the net operating loss deduction without regard to the net operating loss for the loss year or for any taxable year thereafter, and the taxable income so computed shall not be considered to be less than zero.

(c) Net Operating Loss Defined.—For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) Modifications.—The modifications referred to in this section are as follows:

(1) Net operating loss deductions.—No net operating loss deduction shall be allowed.

(2) Capital gains and losses of taxpayers other than corporations.—In the case of a taxpayer other than a corporation—

(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the

amount includible on account of gains from sales or exchanges of capital assets; and

(B) the deduction for long-term capital gains provided by section 1202 shall not be allowed.

(3) Deduction for personal exemptions.—No deduction shall be allowed under section 151 (relating to personal exemptions). No deduction in lieu of any such deduction shall be allowed.

(4) Nonbusiness deductions of taxpayers others than corporations.—In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

(A) any gain or loss from the sale or other disposition of—

(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

(ii) real property used in the trade or business, shall be treated as attributable to the trade or business;

(B) the modifications specified in paragraphs (1), (2) (B), and (3), shall be taken into account; and

(C) any deduction allowable under section 165 (c) (3) (relating to casualty losses) shall not be taken into account.

(5) Special deductions for corporations.—No deduction shall be allowed under section 242 (relating to partially tax-exempt interest) or under section 922 (relating to Western Hemisphere trade corporations).

(6) Computation of deduction for dividends received, etc.—The deductions allowed by sections 243 relating to dividends received by corporations), 244 (relating to dividends received on certain preferred stock of public utilities), and 245 (relating to dividends received from certain foreign corporations) shall be computed without regard to section 246(b) (relating to limitation on aggregate amount of deductions); and the deduction allowed by section 247 (relating to dividends paid on certain preferred stock of public utilities) shall be computed without regard to subsection (a) (1) (B) of such section.

(e) Law Applicable to Computations.—In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years, whether they begin before, on, or after January 1, 1954.

(f) Taxable Years Beginning in 1953 and Ending in 1954.—In the case of a taxable year beginning in 1953 and ending in 1954—

(1) In lieu of the amount specified in subsection (c), the net operating loss for such year shall be the sum of—

(A) that portion of the net operating loss for such year computed without regard to this subsection which the number of days in the loss year after December 31, 1953, bears to the total number of days in such year, and

(B) that portion of the net operating loss for such year computed under section 122 of the Internal Revenue Code of 1939 as if this section had not been enacted which the number of days in the loss year before January 1, 1954, bears to the total number of days in such year.

(2) The amount of any net operating loss for such year which shall be carried to the second preceding taxable

year is the amount which bears the same ratio to such net operating loss as the number of days in the loss year after December 31, 1953, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the reduction for the second taxable year preceding the loss year shall not exceed the portion of the net operating loss which is carried to the second preceding taxable year.

(3) The net operating loss deduction for such year shall be, in lein of the amount specified in section 122 (c) of the Internal Revenue Code of 1939, the sum of—

(A) that portion of the net operaitng loss deduction for such year, computed as if subsection (a) of this section were applicable to the taxable year, which the number of days in such year after December 31, 1953, bears to the total number of days in such year, and

(B) that portion of the net operating loss deduction for such year, computed under section 122 (c) of the Internal Revenue Code of 1939 as if this paragraph had not been enacted, which the number of days in such year before January 1, 1954, bears to the total number of days in such year.

(4) For purposes of the second sentence of subsection (b) (2), the taxable income for such year shall be the sum of—

(A) that portion of the net income for such year, computed without regard to this paragraph, which the number of days in such year before January 1, 1954, bears to the total number of days in such year, and

(B) that portion of the net income for such year, computed—

(i) without regard to paragraphs (1) and (2) of section 122 (d) of the Internal Revenue Code of 1939, and

(ii) by allowing as a deduction an amount equal to the sum of the credits provided in subsections (b) and (h) of section 26 of such Code,

which the number of days in such year after December 31, 1953, bears to the total number of days in such year.

(g) Special Transitional Rules.—

(1) Losses for taxable years ending before January 1, 1954.—For purposes of this section, the determination of the taxable years ending after December 31, 1953, to which a net operating loss for any taxable year ending before January 1, 1954, may be carried shall be made under the Internal Revenue Code of 1939.

(2) Losses for taxable years ending after December 31, 1953.—For purposes of section 122 of the Internal Revenue Code of 1939—

(A) the determination of the taxable years ending before January 1, 1954, to which a net operating loss for any taxable year ending after December 31, 1953, may be carried shall be made under subsection (b) (1) (A) of this section; and

(B) in determining the amount of the carryback to the first taxable year preceding the first taxable year ending after December 31, 1953, the portion of the net operating loss carried to such year shall be such net operating loss reduced by—

(i) the net income for the second preceding taxable year, computed as if the second sentence of section 122 (b) (2) (B) of the Internal Revenue Code of 1939 applied, or

(ii) if smaller, the portion of the net operating loss which by reason of subsection (f) of this section is carried to the second preceding taxable year.

(3) Taxable years beginning after December 31, 1953, and ending before August 17, 1954.—In the case of a tax-

able year which begins after December 31, 1953, and ends before August 17, 1954—

(A) the net operating loss deduction for such year shall be computed as if subsection (a) of this section applied to such taxable year, and

(B) for purposes of the second sentence of subsection (b) (2), the taxable income for such taxable year shall be the net income for such taxable year, computed—

(i) without regard to paragraphs (1) and (2) of section 122 (d) of the Internal Revenue Code of 1939, and

(ii) by allowing as a deduction an amount equal to the sum of the credits provided in subsections (b) and (h) of section 26 of such Code.

(4) Excess profits tax not affected.—For purposes of subchapter D of chapter 1 of the Internal Revenue Code of 1939, excess profits net income shall be computed as if this section had not been enacted and as if section 122 of such Code continued to apply to taxable years to which this substitute applies.

(h) Disallowance of Net Operating Loss of Electing Small Business Corporations.—In determining the amount of the net operating loss deduction under subsection (a) of any corporation, there shall be disregarded the net operating loss of such corporation for any taxable year for which such corporation is an electing small business corporation under subchapter S.

(i) Carryback of Net Operating Loss for Taxable Years Beginning in 1957 and Ending in 1958.—In the case of a table year beginning in 1957 and ending in 1958, the amount of any net operating loss for such year which shall be carried to the third preceding taxable year is the amount which bears the same ratio to such net operating

loss as the number of days in the loss year after December 31, 1957, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the reduction for the third taxable year preceding the loss year shall ont exceed the portion of the net operating loss which is carried to the third preceding taxable year.

(j) Cross References.—

(1) For treatment of net operating loss carryovers in certain corporate acquisitions, see section 381.

(2) For special limitation on net operating loss carryovers in case of a corporate change of ownershiu, see section 382.

* * * * * *

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) In General.—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance

shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

(b) Power of Secretary or His Delegate to Allow Deduction, etc., in Part.—In any case to which subsection (a) applies, the Secretary or his delegate is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, appointed, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraphs (1) and in part under paragraph (2).

(c) Presumption in Case of Disproportionate Purchase Price.—The fact that the consideration paid upon an acquisition by any person or corporation described in subsection (a) is substantially disproportionate to the aggregate—

(1) of the adjusted basis of the property of the corporation (to the extent attributable to the interest acquired specified in paragraph (1) of subsection (a)), or of the

property acquired specified in paragraph (2) of subsection (a); and

(2) of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition,

shall be prima facie evidence of the principal purpose of evasion or avoidance of the Federal income tax. This subsection shall apply only with respect to acquisitions after March 1, 1954.

[redacted]

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 108

MILL RIDGE COAL COMPANY, PETITIONER

v.

GEORGE D. PATTERSON, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. 1a–8a) is reported at 264 F. 2d 713.

JURISDICTION

The judgment of the court of appeals was entered on March 12, 1959 (Pet. 8a). The petition for a writ of certiorari was filed on June 10, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

A corporation with accumulated operating losses disposed of all its assets and went out of business.

New owners then acquired all its stock and used the corporation to operate a new business. The question is whether the corporation may carry over and deduct against the income of the new business the losses incurred in the old business, that having been the principal purpose of its acquisition by the new owners.

STATUTES INVOLVED

Sections 23(s), 122(b), and 129(a) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.) and §§ 172 (a) and (g) and 269(a) of the Internal Revenue Code of 1954 (26 U.S.C., Supp. V) are set forth in the Appendix, *infra*, pp. 11–13.

STATEMENT

From its organization in 1947 until the end of 1953, all the stock of the taxpayer corporation was owned by Charles and Prince DeBardeleben. The taxpayer operated a coal mine in Kentucky from September 1948 until March 1951 and then leased the mine to others until September 1952. It sold the mine and all its physical assets on September 1, 1952, and from then until December 31, 1953, conducted no further business. Its income tax returns showed a net operating loss for every fiscal year from August 31, 1948, to August 31, 1953. (Pet. 2a.)

On December 31, 1953, the taxpayer transferred to Charles DeBardeleben its only remaining asset, the secured note it had received on the sale of its properties. Its balance sheet then showed assets of zero and liabilities (almost entirely debenture notes held by the DeBardelebens) of about $297,000. On the same

date, the DeBardelebens sold all their stock and debenture notes to Elliott T. Williams, Jr., for $5,475.52. In February 1954, new stock certificates were issued to Williams, one William E. Tomlinson, and three other persons. (Pet. 2a.)

The circumstances of the acquisition of taxpayer's stock by the Williams-Tomlinson group were as follows: On December 3, 1953, the Tennessee Coal and Iron Division of the United States Steel Corportation (TCI) agreed to enter a contract to purchase fuel oil from Tomlinson. In November 1953, Tomlinson had formed the Bunker Oil Company to perform the anticipated contract and had sought to interest Williams in the company. After the stock of the taxpayer was acquired by the group, however, it, rather than Bunker, was used to execute the formal contract with TCI (on March 17, 1954), and Bunker was dissolved. The taxpayer began selling fuel oil to TCI on August 31, 1954, and at no time after the purchase of its stock by the group did it engage in the coal business. Williams testified that the principal reason for buying the corporation was to get the tax benefit of its earlier losses, and Tomlinson likewise testified that that was one of the major reasons for his buying stock in the taxpayer. (Pet. 2a–3a; R. 77–78, 86, 91–92.)

On its income tax return for the fiscal year ending August 31, 1955, the taxpayer deducted, as a net operating loss carryover, the losses it had incurred in the coal business while its shares had been owned by the DeBardelebens. The Commissioner disallowed the

deduction, and the taxpayer, having paid the resulting deficiency, brought this suit for refund. (Pet. 2a–3a.) The district court directed a verdict for the respondent (R. 89–95), and the court of appeals affirmed (Pet. 1a–8a).

ARGUMENT

On December 31, 1953, the taxpayer was a defunct corporation. It had no assets, no business, and no prospects. It did, however, have accumulated operating losses which offered the prospect of carryover deductions against future income. New interests then acquired the taxpayer's corporate shell through which to carry on a new business, hoping thereby to utilize the taxpayer's past losses as deductions against the income from the new business. Since taxpayer had nothing else, its purchase was neither more nor less than an attempted purchase of a net operating loss carryover. The courts below held that the Code did not contemplate such a use of operating loss carryovers. That decision, we submit, is clearly correct, and there is no conflict of decisions or other reason for review by this Court.

1. *a.* Although involving a different factual situation, this case is controlled by the rationale of this Court's decision in *Libson Shops, Inc.* v. *Kohler*, 353 U.S. 382. In that case, 17 commonly-owned corporations (separate retail stores and a management company) were merged into one, and the surviving corporation sought to deduct from its subsequent income losses carried over from three of the merged corporations, the businesses of which continued to be

operated at a loss. The controlling provision, § 122(b)(2)(C) of the 1939 Code, provided:

> If for any taxable year * * *, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years * * *.

Although the issue was framed as being whether the surviving corporation was "the taxpayer" which had incurred the losses, the Court expressly declined to make the result turn on whether a corporation resulting from a statutory merger is to be treated as the "same taxable entity" as its predecessors (pp. 385–386). It rested its decision instead on the broader ground that the underlying purposes of the carryover provisions—to ameliorate the hardship of an annual accounting system when a business' income fluctuates from year to year—precluded their application where there is not a "continuity of business enterprise" (p. 368).

In *Libson Shops*, the only lack of continuity (since the same interests owned the corporations both before and after the merger and the businesses, although consolidated, remain unchanged) was that the pre-merger losses of three of the stores were being used to offset the post-merger income of the *other* stores. Here, however, there is a total lack of continuity of any kind, there having been a complete change both of ownership and of business. Admittedly the two enterprises were conducted under the same corporate charter and thus through the same legal "entity", but the *Libson Shops* opinion expressly rejects such formalistic

tests and looks instead to the substance of the relationship between the enterprise incurring the loss and that seeking to deduct it. Looking to the substance here, there was simply an attempt by one enterprise to purchase the accumulated losses of another. Such a use of a carryover deduction—in effect, making a defunct business' loss carryover an independently marketable commodity—is clearly not within the purpose of the carryover provisions.

b. Petitioner contends that this case is governed by § 172 of the 1954 Code rather than the predecessor provision of the 1939 Code (§ 122) construed in *Libson Shops.* Even so, the result is the same. While the reference to "the taxpayer" in § 122 of the 1939 Codes does not appear in § 172 of the 1954 Code, that difference is due only to the change in the form of the carryover provisions in the 1954 Code, and there is nothing to indicate that any difference of substance was intended. In any event, *Libson Shops* turned not, as petitioner contends, on the meaning attributed to the words "the taxpayer," but on the purposes attributed to the carryover provisions as a whole. Those purposes have not been changed by the 1954 Code, and the reasons for reading into § 122 of the 1939 Code a "continuity of business enterprise" requirement are equally applicable to § 172 of the 1954 Code.[1]

[1] While for the above reasons we think the question immaterial, it is our view that the issue in this case is in fact governed by § 122 of the 1939 Code rather than by § 172 of the 1954 Code. Although the taxable year involved is governed generally by the 1954 Code, § 172(g)(1) provides that "the determination of the taxable years * * * to which a net operating

c. Turning to provisions of the 1954 Code other than the basic carryover provisions of § 172, petitioner contends that the judicially-evolved continuity test has been displaced by special provisions defining in detail the circumstances under which carryovers will be disallowed. Those provisions are § 381, which prescribes the extent to which operating loss carryovers survive a reorganization (the *Libson Shops* situation), and § 382, which provides that a single continuing corporation may lose the right to carry over losses upon a substantial change of ownership (essentially, a 50% change) and a simultaneous change of business (the situation here). If those provisions qualify the limitations otherwise implicit in § 172 and recognized in *Libson Shops*,[2] they can do so only in cases to which they apply. And if § 382 did apply here, it would itself disallow the carryover deduction. In fact,

---

loss for any [pre-1954 Code] taxable year * * * may be carried shall be made under the" 1939 Code. Possibly that provision could be read as making the 1939 Code controlling only on the number of years over which a loss can be carried forward, but other provisions of the 1954 Code would seem to require a construction making the 1939 Code controlling also on the question here. The provisions of the 1954 Code dealing with the effect of similar transactions on the right to carry over losses (§§ 381–382, see pp. 7–8, *infra*) were expressly made applicable only to transactions *occurring* after the effective date of the 1954 Code (see § 394 (a) and (b)), and the only reasonable inference is that the effect of prior transactions was to continue to be governed by the prior law—*i.e.*, the 1939 Code.

[2] In the *Libson Shops* situation itself, the Internal Revenue Service has recognized that § 381 is controlling in any case to which § 381(a) applies. T.I.R. No. 89, August 25, 1958; P-H 1958 Fed. Tax Rep. ¶ 55,060.

of course, that section applies only to cases in which the change of ownership occurred after June 22, 1954 (see § 394(b)), so that the effect of changes of ownership and business prior to that time, as in this case, continues to be governed by the implicit limitations of § 172 itself—limitations which, as explicated in *Libson Shops,* equally preclude the deduction here. There is not—as the taxpayer in effect contends—a hiatus during which the express disallowance of such deductions by § 382 is inapplicable but yet is effective to supersede the limitations implicit in § 172. One or the other controls, and on the facts here the deduction would be forbidden by both.

2. As an alternative ground for decision, the court of appeals held that the carryover deduction was also properly disallowed under § 129(a) of the 1939 Code and its successor, § 269(a) of the 1954 Code. In relevant part, those sections identically provide that:

> If * * * any person or persons acquire * * * control of a corporation, * * * and the principal purpose for which such acquisition was made is evasion or avoidance of * * * tax by securing the benefit of a deduction, credit, or other allowance which such person * * * would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. * * *.

Admittedly, the principal purpose of the acquisition here was to utilize the taxpayer's accumulated losses in the coal business as deductions against the profits the new owners anticipated making in the fuel oil business. The only question is whether the fact that the carryover deduction is taken by the acquired

corporation itself, with the acquiring "persons" securing the "benefit" only indirectly, precludes the application of the section. In our view, it clearly does not. In terms, the purpose of the acquiring persons need not be to secure a "deduction" themselves; it need only be a purpose to avoid taxes by "securing the benefit of" a deduction. While the deduction itself can be taken only by the corporation, it is the new owners who will ultimately secure the benefit of the deduction and it was to obtain that benefit that they acquired the corporation. That interpretation has been adopted by the Fourth Circuit (*Coastal Oil Storage Co.* v. *Commissioner,* 242 F. 2d 396) as well as by the court below, and a contrary interpretation of the section as not applying to cases of this sort—perhaps the clearest example of a tax-avoidance dealing in corporate charters—would, we submit, frustrate its very purposes.

3. There is no conflict of decisions among the courts of appeals and, while the Tax Court has adopted a contrary view on both grounds of the decision below, its latest decision on those issues is now pending on review before the Court of Appeals for the Ninth Circuit. *British Motor Car Distributors, Ltd.* v. *Commissioner,* 31 T.C. 437. Since the 1954 Code expressly prescribes the extent to which the right to carry over losses survives changes in ownership and business occurring after June 22, 1954, the question posed by this case is of continually diminishing importance, and in the absence of a conflict of decisions there is no need for review of the question by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JULY 1959.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 23. * * * In computing net income there shall be allowed as deductions:

* * * * * *

(s) * * * For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * * *

SEC. 122[(b)(2)(B)]. * * * If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years, except the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

* * * * * *

SEC. 129. * * * (a) * * * If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal

purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation.

* * * * *

Internal Revenue Code of 1954 (26 U.S.C., Supp. V):

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) *Deduction Allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

* * * * *

(g) *Special Transitional Rules.*—

(1) *Losses for taxable years ending before January 1, 1954.*—For purposes of this section, the determination of the taxable years ending after December 31, 1953, to which a net operating loss for any taxable year ending before January 1, 1954, may be carried shall be made under the Internal Revenue Code of 1939.

* * * * *

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) *In General.*—
If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

* * * * *

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No. 108

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

MILL RIDGE COAL COMPANY, *Petitioner*,

v.

GEORGE D. PATTERSON, DISTRICT DIRECTOR OF INTERNAL REVENUE, *Respondent*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

REPLY BRIEF OF PETITIONER

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IN THE

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

REPLY BRIEF OF PETITIONER

The Government's brief in opposition gives compelling evidence of the need of adjudication of this case by this Court. For that brief centers around several legal premises, all of which are highly controversial and all of which deal with matters of substantial importance.

1. Libson Shops

(a) The Government asserts, at page 4, that this case, involving a single corporate taxpayer, "is controlled by the rationale of this Court's decision in *Lib-*

son Shops, Inc. v. *Kohler*, 353 U.S. 382". But this Court indicated to the contrary, 353 U.S. 390, Footnote 9; the Tax Court has squarely held to the contrary, *British Motor Car Distributors, Ltd.*, 31 T.C. 437; and the legal commentators have stated the contrary, *e.g.*, Levine & Petta, *"Libson Shops Applied to a Single Corporate Taxpayer"*, 36 *Taxes* 562 (1958); 8 *Tax Fortnighter* No. 6 (March 18, 1959); and 9 *Jour. Tax.* 219 (Oct. 1958).

(b) In response to petitioner's contention that the Court below erroneously applied *Libson Shops* to the 1954 Code, the Government not only does not deny but affirmatively asserts, at page 6, that the "continuity of business enterprise" test of *Libson Shops* applies to Section 172 of the 1954 Code. But this Court indicated that that test has been supplanted by Sections 381 and 382 of the 1954 Code, 353 U.S. 385, Footnote 2; the Treasury Department itself apparently stated that it would not seek to apply *Libson Shops* to the 1954 Code, T.I.R. No. 89, August 25, 1958; 9 *Jour. Tax.* 219; and the legal writers have commented vigorously that *Libson Shops* does not apply to the 1954 Code, see Sinrich, *"Libson Shops—An Argument Against Its Application Under the 1954 Code"*, 13 *Tax. L. Rev.* 167 (1958); 9 *Jour. Tax.* 219; see also, Graichin, *"The Net Operating Loss"*, 16 *N.Y.U. Inst. Fed. Tax.* 865, 873-4 (1958).

(c) Any belief that these two problems are esoteric or minor (either in a legal or an economic sense) may be quickly dispelled by recalling the events that transpired during the 1958 annual meeting of the Section of Taxation of the American Bar Association. Following the decision of this Court in *Libson Shops* in May, 1957, the Internal Revenue Service commenced

studying "the problem of how to administer the continuity of business test as to pending cases under the 1939 Code and whether the continuity of business principle applies under the 1954 Code in view of the enactment of §§ 381 and 382". (A.B.A., Section of Taxation, *Bulletin*, p. 25, April, 1958). Ample testimony as to the widespread interest in these problems was given by the Chief Counsel of the Internal Revenue Service when he stated that he had "long since lost count of the number of lawyers who have complained to me about that delay [in issuing a policy statement about *Libson Shops*]". (A.B.A., Section of Taxation, *Bulletin*, p. 9, October 1958). Prior to August 23, 1958, the Service had taken the position that it could not issue a statement of policy in advance of the promulgation of regulations under Sections 381 and 382. At the session of the Tax Section held August 23, however, discussion of these problems consumed most of the day, and a legislative proposal to amend Section 172 expressly to preclude application of *Libson Shops* under the 1954 Code was approved. Shortly thereafter, at that session, the Chief Counsel of the Internal Revenue Service announced the position of the Service (T.I.R. No. 89), even though the regulations under Sections 381 and 382 had not then been proposed (in fact, they have not been proposed as of this date). After this announcement, a motion to reconsider the recommendation of the legislative proposal was adopted, and the following afternoon, the legislative proposal was again discussed, and was again approved. See 9 *Jour. Tax.* 219.

It is difficult to believe that the leading tax practitioners of this country—and, apparently, the Service itself—would spend so much time and effort on these

problems if, as the Government states (at page 9), they are of "continually diminishing importance".

2. Section 172

The Government contends that Section 172 of the 1954 Code must be construed in light of *Libson Shops* (pages 7-8; see also, last sentence of page 6). Thus, the Government argues that, by itself, Section 172 prohibits the use of carryovers if there is a change in business only by a single corporate taxpayer. If this is true, we have the strange anomaly of Section 382(a), termed "Special Limitations on Net Operating Loss Carryovers", being considerably broader that Section 172, the very section it (Section 382) is supposed to limit. For if the Government's theory is correct, a corporation that changed business without a change of stock ownership could not claim the deduction under 172, even though the clear implication of Section 382(a) is that the deduction should be permitted. It seems clear that, in the light of Section 382(a), the business continuity test of *Libson Shops* is not a part of Section 172; otherwise Section 382(a) is meaningless.

Moreover, the word "taxpayer" about which the controversy in *Libson Shops* centered does not appear in Section 172 of the 1954 Code. The Government argues (page 6) that *Libson Shops* did not turn on the meaning of the word "taxpayer" in Section 122 of the 1939 Code. However, in *Libson Shops* this Court specifically said. "The controversy enters on the meaning of 'the taxpayer'. The contentions of the parties require us to decide whether it can be said that petitioner, a combination of 16 sales businesses is 'the taxpayer' having the pre-merger losses of three of those businesses." (353 U.S. at 385). This Court, itself, pointed out that the words "the taxpayer" do not ap-

pear in the carryover provisions of the 1954 Code indicating that this omission may well be significant under the 1954 Code. 353 U.S. 927, Footnote 2.

The Government admits (Footnote 2, page 7) that *Libson Shops* does not apply to mergers, liquidations or reorganizations under the 1954 Code. This admission means that under the Government's view a successor corporation in a merger may use a predecessor's loss carryover incurred in a different business while a single corporate taxpayer, even in the absence of a change of stock ownership, cannot use its own loss carryover incurred in a different business. Obviously, such a result was not intended by Congress in enacting the 1954 Code. Nor does the petitioner contend that there is a hiatus between the 1939 Code and the 1954 Code with respect to a change of business by a single corporate taxpayer. It has never been held in any case decided under the 1939 Code, including *Libson Shops*, or provided in the 1939 Code or in any regulations thereunder that a single corporate taxpayer could not change its business and continue to use its own loss carryover. It was not until the enactment of Section 382(a) of the 1954 Code that such a concept was introduced into the tax laws and Section 382(a) is not applicable to this case.

3. Section 269

With respect to the applicability of Section 269 of the 1954 Code to this case, the Government asserts, at pages 8-9, that "The only question is whether the fact that the carryover deduction is taken by the acquired corporation itself, with the acquiring 'persons' securing the 'benefit' only indirectly, precludes the application of the section. In our view it clearly does not." The Tax Court, however, in *British Motor Car Dis-*

tributors, Ltd., supra, has squarely held to the contrary: "While its new stockholders may gain some tax advantage as stockholders because of petitioner's use of its losses, it is still the petitioner and not the stockholders who seek to claim the benefit in the case before us. *We think the possible benefit which may flow to the stockholders is too tenuous a benefit to bring Section 129 into play.*" (Our emphasis). It is significant also that the regulations promulgated under Section 129 of the 1939 Code do not suggest such an interpretation. Regs. 118, Sec. 39.129-3 (b).

The Government attempts to buttress its argument by claiming that "While the deduction itself can only be taken by the corporation, it is the new owners who will ultimately secure the benefit of the deduction . . .". Presumably this assertion is based on the conception that the corporation will be successful and pay dividends or be liquidated at a profit. Of course, there is no assurance that the petitioner will be successful; in fact the mortality rates for small corporations would indicate that the chances are to the contrary. Moreover, this argument of the Government is premised upon disregarding the fact that the petitioner is a corporate taxable entity separate from its stockholders and the benefit of the deduction in question is obtained by the corporation and not its stockholders. As stated at page 15-16 of the petition, the doctrine of *Higgins* v. *Smith*, 308 U.S. 473 (1939), on which the decision in *Coastal Oil Storage Co.* v. *Commissioner*, 242 F. 2d 396 (4th Cir. 1957), was based, is not applicable to this case.

The position of the Government that a stockholder of a corporation, for purposes of Section 269, obtains the benefit of all the tax savings of the corporation

leads, without extending logic unduly, to the unique proposition that anyone who forms a corporation to save taxes (and it is undoubtedly for tax purposes that thousands of corporations are organized each year) runs afoul of Section 269. Thus, if the Government's interpretation of Section 269(a)(1) is correct, every incorporation of a partnership or sole proprietorship to place the earnings thereof in a lower tax bracket would come within the prohibitions of Section 269(a)(1) because the partners or sole proprietor would acquire control of a corporation for the purpose of securing a tax benefit (the surtax exemption to which a corporation is entitled) which the partners or sole proprietor would not otherwise enjoy. Congress, we submit, never contemplated such an interpretation of the law.

4. National Importance of This Case

In our petition, we pointed out that this case deals not only with important and controversial matters of law but also with matters of law that vitally affect a large number of taxpayers. Another gauge to the soundness of these contentions is the fact that as of this date, almost five years after the enactment of the 1954 Code and more than two years after the decision of this Court in *Libson Shops*, the Department of Treasury has yet to promulgate or even propose regulations under Sections 269, 381 and 382. The regulations issued under Section 172 do not suggest in any way that there is a business continuity test in applying Section 172. Various inferences may be drawn from the delay in issuing regulations under Sections 381, 382, and 269, but it seems reasonable to conclude that the primary reason for that delay is that the Department of Treasury itself is not yet certain of the official

position that it will take with respect to the interpretation of these sections. If such be the case, the issues in this case are certainly not as clear and non-controversial as the Government's brief seeks to indicate.

The Government suggests (page 9) that this case is of diminishing importance because an instance such as the one involved in this case in which there is both a change of stock ownership and a change of business is now covered by Section 382(a) of the 1954 Code. But this statement ignores the fact that the Government seeks to sustain the decision in this case in the Court below solely on the basis of a change of business, relying on *Libson Shops* which did not involve a change of stock ownership. This is clearly a question of continuing and vital importance under the 1954 Code as evidenced by the concern of the leading tax practitioners in the nation. See Winton, "*Loss Carryovers: courts grope toward judicial doctrine of business continuity*", 11 *Jour. Tax*, 76 (Aug. 1959).

The Government also seeks to sustain the decision below on its interpretation of Section 269(a)(1) of the 1954 Code which is in direct and irreconcilable conflict with decisions of the Tax Court. The Tax Court decision in *British Motor Car Distributors, Ltd.* was reviewed by the entire Tax Court, and therefore, will be followed by the Tax Court despite conflicts with courts of appeal or even reversals by courts of appeal until the issue is resolved by this Court. In *Arthur L. Lawrence*, 27 T.C. 713 (1957) the Tax Court in an opinion reviewed by the entire court without a dissent stated that since it was a court of national jurisdiction it would "to avoid confusion . . . follow its own honest beliefs until the Supreme Court decides the point". 27 T.C. at 716-7, 719-20.

As stated in the *Lawrence* case the Commissioner of Internal Revenue has the duty of administering the taxing statutes uniformly throughout the United States. The Tax Court has a similar duty of uniformly interpreting the taxing statutes. These two national agencies are in direct conflict over the interpretation of Sections 172 and 269(a)(1) of the 1954 Code and this conflict can only be resolved by the Congress or this Court. There appears to be no indication that Congress will resolve this conflict. In view of the obvious importance of net operating loss carryovers to taxpayers and to the Government (see pages 9 and 10 of the petition), this is clearly a case of national importance which should be decided by this Court.

We respectfully urge that the petition for a writ of certiorari be granted.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 108

MILL RIDGE COAL COMPANY, *Petitioner*,

v.

GEORGE D. PATTERSON, District Director of Internal Revenue, *Respondent*.

PETITION FOR REHEARING OF THE DENIAL OF THE PETITION FOR A WRIT OF CERTIORARI

To the

United States Court of Appeals for the Fifth Circuit

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PETITION FOR REHEARING OF THE DENIAL OF THE PETITION FOR A WRIT OF CERTIORARI

To the

United States Court of Appeals for the Fifth Circuit

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Pursuant to the provisions of Paragraph 2 of Rule 58 of the rules of this Court, Petitioner requests a rehearing of this Court's denial of the petition for a writ of certiorari in this case.

The order denying the petition for a writ of certiorari was dated October 12, 1959. We have since been informed that *British Motor Car Distributors, Ltd.,*

31 T.C. 437 (1958) has been set for an oral hearing on November 12, 1959 before the Court of Appeals for the Ninth Circuit. We believe that a decision will be rendered by the Court of Appeals for the Ninth Circuit within several months after the oral hearing.

The decision of the Tax Court in the *British Motor Car* case is directly in conflict with both grounds of the decision of the Court of Appeals for the Fifth Circuit in the instant case. This is conceded by the Government at page 9 of its brief in opposition to the instant petition for a writ of certiorari. In the Government's brief before the Court of Appeals in the *British Motor Car* case the Government stated that, "The case at bar [*British Motor Car*] is in all material respects indistinguishable from *Mill Ridge Coal Co.* v. *Patterson*, 264 F. 2d 713 (C.A. 5th), petition for certiorari filed June 10, 1959, and it is the position of the Government that the result should be the same." If, in the *British Motor Car* case, the Court of Appeals should affirm the decision of the Tax Court and a petition for writ of certiorari is subsequently filed by the Government, then this petition for rehearing should be granted so that both the *Mill Ridge* and *British Motor Car* cases can be considered by this Court at the same time.

The principles of federal income taxation involved in the *Mill Ridge* and *British Motor Car* cases are of broad application and of national importance and should be applied uniformly to all taxpayers. In *United States* v. *Ohio Power Company*, 353 U.S. 98 (No. 312 Oct. Term, 1955, decided April 1, 1957) this Court in vacating an order denying a petition for rehearing after successive petitions for rehearing had been denied, stated that "The interest in finality of

litigation must yield where the interest of justice would make unfair the strict application of our rules." 353 U.S. at page 99. This principle is particularly applicable in tax cases where the United States has an obligation to treat all taxpayers uniformly.

Because of the twenty-five day period provided by Rule 58 within which a petition for rehearing must be filed, petitioner is unable to delay filing this petition for rehearing until after a decision is rendered in the *British Motor Car* case. Accordingly, Petitioner requests that this Court hold this petition for rehearing in the breast of the Court and further requests that this petition for rehearing be granted at such time as a petition for a writ of certiorari may be filed in the *British Motor Car* case.

Respectfully submitted,

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Certificate Pursuant to Rule 58-2

The undersigned counsel for the Petitioner herein certifies that this petition for rehearing is presented in good faith and not for delay, and that the foregoing petition is restricted to the grounds above specified.

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Attorney for Petitioner